

# **Report of the auditor-general to Free State Legislature and the council on the Kopanong Local Municipality**

## **Report on the audit of the financial statements**

### **Qualified opinion**

1. I have audited the financial statements of the Kopanong Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Kopanong Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora).

### **Basis for qualified opinion**

#### **Payables from exchange transactions**

3. Differences were identified between the amounts recognised as payments received in advance in note 15 amounting to R9 226 816 (2017: R5 798 087) and the supporting documentation for payments from consumers. Consequently, payables from exchange transactions are overstated by R8 369 431 (2017: R5 798 087) and receivables from exchange and receivables from non-exchange transactions understated by the same amount in total. It was impractical to determine the amount of the understatement for the different types of receivables. In addition, differences were identified between third-party statements and the salary control in note 15 amounting to R68 244 682 (2017: R59 130 474), resulting in trade and other payables from exchange transactions being overstated by R7 257 049 (2017: R9 234 873) and employee cost being overstated by the same amount. Furthermore, retention liabilities in note 15 amounting to R1 488 471 were not recorded in all instances and are understated by R4 116 138, while trade payables in note 15 are overstated by the same amount.
4. During 2017, I was unable to obtain sufficient appropriate audit evidence for the retention liability as disclosed in note 15, as internal controls had not been established for the recognition of retention. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other payables from exchange transactions stated at R313 883 562 in the financial statements.

## Government grants and subsidies

5. The municipality did not recognise government grants when the related expenditure was incurred as required by GRAP 1, *Presentation of financial statements*. The operating grants amounting to R9 490 771 were only recognised when the payment was made, which is contrary to GRAP 1. Consequently, government grants and subsidies amounting to R113 878 451 are overstated in the current year and understated in the prior year by this amount, with a consequential impact on trade payables in note 15.

## Revenue from exchange transaction

6. The municipality did not account for all revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions*. There were inadequate internal controls in place to ensure that consumers were billed for all relevant services. Consequently service charges amounting to R100 848 179 as disclosed in note 18 are understated by R7 532 248.

## Receivables from exchange transactions

7. During 2017, gross receivables from exchange transactions disclosed in note 9 were not assessed for impairment in the prior year as per the requirements of GRAP 104, *Financial instruments*. The municipality only made a general provision and did not consider whether objective evidence exists that individually significant receivables and/or a group of receivables with similar credit risk characteristics are collectively impaired. As the relevant information pertaining to the estimated future cash flows was not available, I was not able to determine the impact on the net amount for receivables from exchange transactions, as it was impracticable to do so. Furthermore, I was unable to obtain sufficient and appropriate audit evidence for the difference noted between the gross debtors' amounts per the financial statements and the gross debtors' amounts used in the impairment calculation. Additionally, there was a resultant impact on the prior year debt impairment as disclosed in note 30. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from exchange transactions stated at R24 219 365 in the statement of financial position.

## Receivables from non-exchange transactions

8. During 2017, gross receivables from non-exchange transactions as per note 10 were not assessed for impairment as per the requirements of GRAP 104, *Financial instruments*. The municipality only made a general provision and did not consider whether objective evidence exists that individually significant receivables and/or a group of receivables with similar credit risk characteristics are collectively impaired. As the relevant information pertaining to the estimated future cash flows was not available, I was not able to determine the impact on the net amount for receivables from non-exchange transactions, as it was impracticable to do so.

## Context for the opinion

9. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.

10. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
11. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Material uncertainty relating to going concern**

12. I draw attention to the matter below. My opinion is not modified in respect of this matter.
13. Note 42 to the financial statements, which indicates that the municipality incurred a net loss of R84 681 321 (2017: R73 690 646) during the year ended 30 June 2018 and, as of that date, the municipality's current liabilities exceeded its current assets by R367 735 248 (2017: R285 603 119) and that the municipality experienced cash flow problems during the year which resulted in major creditors not being paid timeously. As disclosed in note 47 to the financial statements, the municipality has been deducting taxes, pension fund and medical aid contributions from employees' salaries, but has not been unable to pay over R57 933 841 (2017: R40 297 973) to the relevant third parties. These conditions, along with other matters as set forth in note 42 indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

### **Emphasis of matters**

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Unauthorised expenditure**

15. As disclosed in note 44 to the financial statements, the municipality incurred unauthorised expenditure of R39 354 259 (2017: R67 387 246) during the year due to the actual expenditure incurred exceeding the budgeted amounts.

#### **Irregular expenditure**

16. As disclosed in note 46 to the financial statements, the municipality incurred irregular expenditure of R22 819 770 (2017: R32 619 153) during the year due to conditional grants being used for other purpose and non-compliance with supply chain management (SCM) requirements. In addition, the full extent of irregular expenditure during the year was still in the process of being determined.

### **Fruitless and wasteful expenditure**

17. As disclosed in note 45 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R28 286 201 (2017: R24 185 848) during the year mainly due to interest and penalty charges on the late payment of suppliers.

### **Restatement of corresponding figures**

18. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors discovered during 2017-18 in the financial statements of the municipality at, and for the year ended, 30 June 2018.

### **Material losses**

19. As disclosed in note 47 to the financial statements, material electricity losses of R7 882 478 (2017: R8 278 827) which represents 17% (2017: 4%) of total electricity purchased, were incurred by the municipality, mainly due to aging electricity infrastructure.
20. As disclosed in note 47 to the financial statements, water distribution losses of R13 843 212 (2017: R13 512 953) which represents 50% (2017: 46%) of total water purchased, were incurred by the municipality, mainly due to aging water infrastructure.
21. As disclosed in note 9 to the financial statements, material losses of R6 668 676 (2017: R25 564 220) were incurred as a result of a write-off of irrecoverable receivables from exchange transactions.

### **Material impairment**

22. As disclosed in notes 9 and 10 to the financial statements, receivables from exchange and non-exchange transactions were impaired by R184 086 118 (2017: R141 858 415) and R25 432 190 (2017: R20 415 343) respectively.

### **Underspending of conditional grants**

23. As disclosed in note 23 to the financial statements, the municipality materially underspent the municipal infrastructure grant and the water services infrastructure grant by a combined R23 357 982 (2017: R13 686 620).

### **Other matters**

24. I draw attention to the matters below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

25. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **Responsibilities of the accounting officer for the financial statements**

26. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
27. In preparing the financial statements, the accounting officer is responsible for assessing the Kopanong Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

## **Auditor-general's responsibilities for the audit of the financial statements**

28. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
29. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

30. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance areas (KPA's) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
31. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/ measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
32. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA's presented in the annual performance report of the municipality for the year ended 30 June 2018:

KPA	Pages in the annual performance report
Service delivery and infrastructure development – technical services	x – x
Service delivery and infrastructure development – community services	x – x

33. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
34. The material findings in respect of the usefulness and reliability of the selected KPAs are as follows:

#### Service delivery and infrastructure development – technical services

##### Various indicators

35. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the indicators listed below. This was due to the performance indicators and targets not being well defined as it did not allow for consistency of data collection, and the performance measures not being verifiable, contrary to the Framework for managing programme performance information (FMPPI). I was unable to confirm that the reported achievement of these indicators was reliable by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement.

Indicator	Reported achievement
Supply and Installation of Water Meters, Valves & Fire Hydrant 1. Philippolis 2. Fauresmith 3. Reddersburg	0
Upgrading of bulk water steel pipe in Bethulie	0
Upgrading of bulk Pipeline in Philippolis	0
Upgrading of Waste water Treatment Works in Philippolis	1
Fixing of leakages to households in Kopanong	0
Construction of 1km paved access road in Fauresmith by 30 June 2018	1
Construction of 600m Paved access road in Bethulie by 30 June 2018	1



36. There was no clear and logical link between the indicator and the target to which it relates in the following instances. Furthermore, the indicators were not well defined, as the target was not specific and measurable.

Indicator	Reported achievement
115 Households electricity connection in Bethanie by 30 June 2018	1
1 Mini substation in Bethulie by 30 June 2018	1

37. The measures taken to improve performance against the following targets were not included in the annual performance report:

Indicator	Reported achievement
Upgrading of bulk Pipeline in Philippolis	0
Fixing of leakages to households in Kopanong	0

38. The reported measures taken to improve performance against the planned target, did not agree to the supporting evidence provided for the following indicators:

Indicator	Reported achievement
Monitoring of Construction of a Concrete 3 Mgl Reservoir and distribution of 3km water Pipeline in Trompsburg	3
Construction of 1.2 km pipeline and refurbishment of pump station in Reddersburg	0

## Service delivery and infrastructure development – community service

### Various indicators

39. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the indicators listed below. This was due to the performance indicators and targets not being well defined as it did not allow for consistency of data collection and the performance measures not being verifiable, contrary to the FMPPI. I was unable to confirm that the reported achievement of these indicators was reliable by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement.

Indicator	Reported achievement
Identification of Backlogs for Households Connection	1
Monitoring and maintenance of internal reticulation network (water)	2
Removal of household refuse fortnightly	1
Patching of potholes in all 9 Towns Bi-annually	0

## Other matters

40. I draw attention to the matters below.

### Achievement of planned targets

41. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 35 to 39 of this report.

### Adjustment of material misstatements

42. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of service delivery and infrastructure development – technical services. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

## Report on the audit of compliance with legislation

### Introduction and scope

43. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

44. The material findings on compliance with specific matters in key legislations are as follows:

### Annual financial statements

45. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.



46. The annual financial statements were not submitted to the auditor-general, for auditing, within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
47. The annual financial statements were not submitted to the auditor-general within two months after the end of the financial year and written explanation setting out the reasons for the failure were not tabled in council as required by section 133(1)(a) of the MFMA.

#### **Expenditure management**

48. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
49. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R39 354 259, as disclosed in note 44 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by the impairments of debtors.
50. Reasonable steps were not taken to prevent irregular expenditure amounting to R22 819 770 as disclosed in note 46 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the SCM laws and regulations. Irregular expenditure amounting to R3 809 406 was incurred on key projects.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R28 286 201, as disclosed in note 45 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by interest on late accounts.
52. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors and payments made, as required by section 65(2)(b) of the MFMA.

#### **Revenue management**

53. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

#### **Conditional grants**

54. The municipal infrastructure grant and water services infrastructure grant were not spent for their intended purposes in accordance with the applicable grant framework, as required by section 17(1) of Dora.
55. Performance in respect of programmes funded by the municipal infrastructure grant and water services infrastructure grant was not evaluated, as required by section 12(5) of Dora.

#### **Human Resource Management**

56. Appropriate systems and procedures to monitor, measure and evaluate the performance of staff were not developed and adopted, as required by section 67(1)(d) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
57. I was unable to obtain sufficient appropriate audit evidence that the municipal manager and senior managers previously dismissed for financial misconduct were re-appointed only after the expiry of the 10-year term, as required by section 57A(3) of the MSA.

### **Strategic planning and performance management**

58. The performance management system and related controls were inadequate as it did not describe how the performance monitoring, measurement, review, reporting and improvement processes should be managed as required by municipal planning and performance management regulation 7(1).

### **Consequence management**

59. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
60. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA
61. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

### **Procurement and contract management**

62. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
63. Some quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
64. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year.
65. Some contracts were awarded to bidders based on pre-qualification criteria that differed from those stipulated in the original invitation for bidding, in contravention of preferential procurement regulation 4(1) and 4(2) of 2017. Similar non-compliance was also reported in the prior year.
66. Bid documentation for the procurement of commodities designated for local content and production, did not stipulated the minimum threshold for local production and content as required by preferential procurement regulation 8(2) of 2017.

### **Other information**

67. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected KPAs presented in the annual performance report that have been specifically reported in this auditor's report.
68. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

69. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPAs presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
70. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, and if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

### Internal control deficiencies

71. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
72. There was a slow response from the leadership to implementing and monitoring the audit action plan to address qualification areas and internal control deficiencies identified during the previous audits. As a result, addressing these deficiencies was again a last minute effort to avoid audit report matters. Management was also slow to implement municipal policies and procedures.
73. Management did not in all instances monitor the completeness of source documentation in support of actual achievements reported in the annual performance report. Findings from the prior year on the usefulness of indicators were also not addressed to prevent similar issues in the year under review. This was due to a lack of sufficient skills and experience within the performance management unit resulting in ineffective monitoring and review.
74. Management did not adequately respond to the recommendations of the external auditors to implement processes to monitor and report on compliance with laws and regulations. This was further hindered by the instability in managers positions during the year. This resulted in a situation where non-compliance continued to occur and re-occurred during the year under review.
75. The leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, as not all of the unauthorised, irregular, and fruitless and wasteful expenditure was investigated during the financial year.
76. The governance structures of the municipality were not sufficiently capacitated and as a result did not deliver on their mandates. Consequently, the governance structures did not take into account all the risks that affected the municipal environment and did not monitor the implementation of the recommendations of the risk management division.

## Other reports

77. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
78. The municipality is still awaiting a report from the Special Investigating Unit (SIU) relating to several issues of non-compliance with the municipal policies. As reported previously, the SIU had still not reported back to the municipality on these issues at the time of this report.

*Auditor - General*

Bloemfontein

31 January 2019



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

## **Annexure – Auditor-general's responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected KPAs and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Kopanong Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.